

**TESTIMONY OF ANDREW NATSIOS,
ADMINISTRATOR,
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)
ON THE MILLENNIUM CHALLENGE ACCOUNT
BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL MONETARY POLICY,
TRADE AND TECHNOLOGY
WEDNESDAY, JUNE 11, 2003**

Thank you Chairman King and Members of the Subcommittee for holding this important hearing on the Millennium Challenge Account (MCA). We appreciate your interest in this legislation, and we look forward to close cooperation with you and your subcommittee as we move ahead to establish what I believe is a revolutionary new development initiative.

I will focus my remarks on three key areas: (1) how the experience of USAID and other development institutions has shaped the MCA; (2) how we see the MCA complementing the work of USAID and refocusing USAID priorities; and (3) our vision for how the MCA will be implemented in the field.

I would like to preface my remarks by noting that the process for developing the framework for the MCA and the legislation has truly been a model of interagency coordination. Thanks to the active involvement of key departments and agencies, we were able to coalesce the comparative advantages of those parts of the government already deeply involved in bilateral and multilateral assistance programs. The State Department coordinated outreach with key international and domestic constituencies; the Treasury Department, which has responsibility for the multilateral development banks, played a central role in developing the indicators; USAID, based on its extensive field experience, offered ideas and proposals on the framework and implementation of the MCA. Together, our ideas have been drawn on, and in many cases adopted, as fundamental principles of the proposed new account.

I would also like to underscore the point that we need to see the MCA as only one piece of an unprecedented and concerted commitment of President Bush to increase and improve the effectiveness of foreign assistance. It began with his efforts to forge a new international consensus on development at the Monterrey Financing for Development Conference a year ago and the proposal for the MCA. At the heart of that consensus is that the donor countries will work to mobilize more money for development, while developing countries take more responsibility for creating a sound policy environment. In February, the President submitted a budget to Congress requesting a dramatic increase in the 150 account of development and humanitarian assistance from \$7.7 billion in Fiscal Year 2002 to over \$18 billion by Fiscal Year 2008. Much of that increase will go toward urgent crises, such as stemming the global HIV/AIDs pandemic. But it also includes as much as \$20 billion for MCA, beginning with \$1.3 billion in Fiscal Year 2004 and stabilizing at \$5 billion per year by Fiscal Year 2006. It is clear that this

Administration has taken development off the back burner and placed it squarely at the forefront of our foreign policy.

From the perspective of USAID, the MCA is a welcome and bold initiative that will complement and provide a model for our mission. We see USAID's role as key in the President's all-out campaign to attack the scourge of poverty by stimulating economic growth, promoting democracy and investing in people. But USAID is only one piece of what is now becoming a more coherent and coordinated United States development strategy. For the first time, we have the opportunity to articulate and implement a U.S. strategy that clearly and accurately defines our different challenges and matches the right tools to address them. MCA will play a critical role in this process as we begin to redefine U.S. development assistance to address the very different challenges we face today.

THE ROOTS OF THE MCA

The MCA symbolizes a dramatic turning point, both in putting into practice what we know works in development and in elevating development as a fundamental aspect of our foreign policy. The MCA is the direct outgrowth of what USAID and other development actors have learned over the past fifty years. We not only have considerable first-hand experience about what has worked and what hasn't, but we also have the benefit of considerable recent analysis by the World Bank and leading analysts that support this experience. Put simply, economic development assistance in poor countries works best when you are pursuing good policies that are conducive to growth. We know that good governance, policies and institutions are key; real country ownership is also essential. And we know that performance must be measured using rigorous and unbiased indicators. These are the foundations for the MCA.

A recent World Bank paper summarizes the key themes of what has become a consensus among development specialists worldwide: "The collective record of the past yields three main lessons. First, good development outcomes require good policies and institutions. Second, if development progress is to be sustained, the underlying policies and institutions must be country-owned and country-specific. Third, when these conditions are in place, development assistance can be highly effective." The MCA criteria of good governance, economic freedom, and sound investments in people are indicative of the policies and institutions that determine a country's development success.

We know that money will not solve the problem of bad policy. The fact that it is not the quantity of aid that counts, but the quality, was at the heart of the debate in Monterrey. We know that throwing money at the problem, or meeting "ODA quotas" is not the answer. The MCA also recognizes that foreign aid can, at best, play a supporting role in a country's development; a country's commitment to help itself is the primary determinant of success. We know that private capital flows far outweigh development assistance, and that in the age of globalization, developing countries can undertake reforms that value private trade and investment for development.

We believe a key aspect of persuading countries to improve their policies or institutions is to provide the right incentives. This is why USAID actively promotes the principles of rewarding performance rather than promises, rewarding good governance, establishing local ownership, civil society and private investor participation, and streamlining the assistance delivery process, all of which are reflected in the MCA.

I want to highlight in particular the critical importance of governance. The emphasis on governance in the MCA reflects a fundamental lesson we have learned through hard experience; no amount of money from afar can compensate for or overcome corrupt local leaders or the absence of political will. Overcoming poverty and fostering growth requires governments to become more transparent, inclusive, lawful and responsible to their citizens. Money can't buy this commitment or these kinds of reforms. There needs to be the will to actually pursue these goals. These kinds of reforms, however, can be supported, encouraged and even reinforced by rewards for governments that are moving in this direction. Good performers should be tangibly rewarded with increased development assistance from the international community, incentives for foreign investment, and trade liberalization. Democratic, accountable governance with responsible economic policies should bring immediate and sustained benefits.

To be sure, some East Asian states have contained corruption and achieved rapid development under authoritarian rule. But worldwide, these states have been the exception. Over the past two decades, the two most rapidly developing countries in Africa have been the only two African states to sustain democracy continuously since independence, Botswana and Mauritius. Recent research shows that institutions and policies explain most of the variation across countries in economic development, with property rights, control of corruption, civil liberties, and political rights all significant factors accounting for development success. It has been found that at every level of national development, fewer infants die in democracies than in dictatorships. But actually linking aid to development performance is a radical step. This is one of the reasons why MCA marks a revolution in foreign assistance. Because MCA countries and institutions will have demonstrated capacity to achieve results, the new Millennium Challenge Corporation (MCC) will be able to employ a new way of doing business that relies on host country institutions to manage development activities.

RELATIONSHIP TO USAID

The revolution does not stop with the MCA. It has just begun. The themes of the critical importance of governance and country ownership, the emphasis on performance and accountability, must infuse all of our development assistance. That is why, working under the inspired leadership of Secretary Powell, we initiated a series of reforms at USAID two years ago. We knew that the major changes of the past decades had dramatically altered the landscape for development and that we needed a new direction for U.S. foreign assistance, and hence produced the recent report, *Foreign Aid in the National Interest*. We took up the challenge of drawing these lessons together to begin to formulate the outline for a new framework for US foreign assistance.

We had already begun making some of the changes in USAID suggested by the report, incorporating lessons learned, such as making governance an essential cross-cutting theme, and adopting strategic budgeting approaches as we reorient ourselves and adapt to the current challenges. USAID, however, is only one piece of the picture of USG foreign assistance. As you well know there are numerous U.S. departments and agencies – the State Department, the Treasury Department, the Department of Defense, the Peace Corps, to name only a few – that all have different roles and objectives in providing assistance. Putting these different pieces altogether, many of them with very diverse mandates, is no small task. Indeed, the MCA is the cornerstone of putting America's foreign aid back in order: renewing the focus on economic growth, integrating the nation's foreign affairs expertise, and mobilizing new resources for development.

This is why the MCA, which has boldly and forcefully articulated a new vision for development - with the resources to support it - has such a critical role to play in stimulating and focusing the debate on foreign assistance. Not only is it driving the debate in the United States, but it has also grabbed the attention of our international colleagues, who are all watching the progress of the MCA with great interest. It presents all of us who care about development with both a strong challenge and a historic opportunity. It gives us a clean slate to make the case to the American public and the international community that development is critical to global stability and that it can work.

To those who have questioned whether USAID feels threatened by the MCA, I would answer, to the contrary. We welcome the MCA as the strongest possible commitment by the Administration to making development a core element of our foreign policy. Not only does it embody the right philosophy and approach to development and potentially provide a model for development, but it also gives USAID the opportunity to clarify its role and better focus its activities within the context of a coordinated U.S. development strategy.

We view the MCA as our leading edge, targeted on spurring growth in the best performing poorest countries, providing the level of resources that can really make a difference in moving them to a higher growth trajectory. It will rely on country institutions - investors, business people, political leaders and civil society - to design and lead the economic growth of the country. But MCA, due to its strict criteria, will only assist a limited number of countries. That leaves the large majority of the developing world to USAID and other agencies and actors.

Given our strong interest in supporting and complementing the Millennium Challenge Corporation, USAID has been reviewing its portfolio to determine the best way to organize itself both to support the mission and operations of the MCC and to fulfill our mandate to help a wider range of developing countries. In addition to providing support that may be needed in MCA countries, we believe that USAID should focus activities on four broad groups of countries: (1) countries that just miss getting into the MCA; (2) the mid-range performers with the will to reform; (3) failed or failing states

that need post-conflict, transition or humanitarian assistance; and (4) countries requiring assistance for strategic national security interests.

I would like to highlight our belief that the central objective of focusing on performance, particularly responsible governance, and focusing on good performers must infuse all our development efforts – not just the MCA – and those of other bilateral and multilateral donors as well. This is the way that MCC can serve as a model for all of our assistance programs.

In the first group of countries, USAID will concentrate on the specific areas needed to help a country become eligible for MCC funds. For example, if a country just missed on the investing in people area, USAID would concentrate its programs in that area to help it qualify for MCC funds in a future round. In the second group of countries which are unlikely MCA candidates in the near term, we will need to assess the commitment to political and economic reform.

Where such a commitment exists, we will concentrate on building local capacity and institutions that can support the foundation of MCA assistance, i.e., ruling justly, promoting economic freedom, and investing in people. For those countries that lack such a commitment, we will continue programs that address global issues such as HIV/ AIDS and environmental degradation, but will need to review broader development assistance. We are already beginning this process of applying an MCA lens to our country programs, informing resource decisions with analysis of democracy and sound governance.

In the third group USAID has responsibility for countries and situations that do not lend themselves to assistance guided by MCC criteria, such as in failing, failed and conflict states. As the National Security Strategy states, “America is now threatened less by conquering states than we are by failing ones.” Fully two-thirds of the countries where USAID works have suffered violent conflicts within the last five years. We know that conflict is complex and that interventions must focus on multiple dimensions. We are actively developing new assistance models that will integrate emergency relief and food with transitional assistance, governance investments and civil society building. We must approach these states with targeted, flexible support that emphasizes conflict prevention and the nesting of short, medium and long-term issues in our program designs

Humanitarian assistance also remains central to USAID’s portfolio. Originally designed to respond to natural disasters, humanitarian interventions are increasingly necessitated by complex emergencies caused by conflict, failed and failing states. We restructured our humanitarian assistance to create a new Bureau of Democracy, Conflict and Humanitarian Assistance to make sure that democracy, governance programs, conflict, mitigation and prevention are at the heart of our response to failing states. We have also increased our funding levels to nearly \$2 billion. Recognizing the need for greater flexibility in responding to humanitarian emergencies and failing states, the President requested a new contingency fund to facilitate the quick response that is critical in complex emergencies.

Finally, USAID will continue to respond to needs in countries of strategic national importance or transnational threats recognizing that the primary objectives typically fall under national security and foreign policy more than development. These political challenges will continue to arise, frequently related to the war against terrorism. As much as possible they are funded out of Economic Support Funds (ESF) or other assistance. USAID will work quickly, flexibly, and effectively to achieve overall U.S. Government objectives.

In addition to adapting our programs to support and complement the MCC, there are of course other ways that we will be working closely with the MCC. Foremost will be detailing staff to the Corporation. We view the long experience of USAID's development professionals as an invaluable asset to the new corporation. As I will outline below, we also envision that USAID support to the MCC in the field will be required, given the lean staffing currently envisioned.

On the broadest policy and programmatic level, I expect to coordinate closely with the CEO of the MCC, given our complementary roles. This will be paralleled by coordination on a programmatic level. While some have questioned whether the establishment of the MCC doesn't complicate our development efforts, I would suggest that today's reality is already a complicated one. There are many actors involved in development. The addition of the MCC, which brings such significant and welcome new resources applied to the best development practices, has the opportunity to bring greater strategic focus to our entire development framework. In the months ahead, we plan to actively participate in the further intellectual and operational development of the MCA.

IMPLEMENTATION

Turning to the question of how the MCA will actually be implemented in the field, I need to preface my comments by saying that very few of the details have been worked out. However, I will try to lay out a very broad vision for you of how the MCC might work, subject to revision, once we get the Corporation up and running.

MCA programs will be founded on a partnership and be very focused on one or two key strategic objectives that the country has identified as their top priority to stimulate growth. In order to develop a proposal, we are asking countries to engage in a consultative process with all the relevant civil society and private sector groups. One of the central principles of the MCA is that it be a transparent process from start to finish. This is why it is important that the initial phase of developing a country proposal set the tone and foundation for the development partnership. While the process may vary considerably from country to country, the themes of transparency and country leadership and ownership of the proposal are critical.

In some cases, technical assistance may be required to help a country develop a proposal, which the MCC could offer. However, the country will be managing the process; it will not be a case of the MCC hiring consultants to develop a proposal it wants.

If a country's proposal is selected, a country contract would be negotiated between the MCC and government. This does not imply that those funds will only go to the government. To the contrary, it is anticipated that MCC funds will go to a variety of national and community actors and alliances. However, the government will sign the agreement with the MCC and have overall responsibility for managing and overseeing the contract. The reason we chose a contract approach is to underscore that both parties have an obligation to meet the terms and conditions outlined in the contract.

We anticipate that MCC funds will mobilize a variety of economic actors in each country; to the extent that a development result requires a public sector investment (schools or roads), funds would be channeled through the government. However since economic growth inevitably depends on the activities and investments of the private productive sectors, community groups and civil society organizations, we expect that these institutions would also participate, and even implement the bulk of the investments. In all cases, we expect that MCC funds would be disbursed directly to the institutions implementing activities under the MCC contract through the most flexible, but accountable mechanisms.

If a country selected for MCC funding has a USAID mission and program, we would likely undertake a strategic review of the program. In many cases, we would see the USAID program transition to support the MCC contract. Some programs, such as those fighting HIV/AIDS or trafficking in persons, might well be continued, while others might logically be phased out or incorporated in the MCC program. Indeed, one of the ways that USAID will complement the MCC is that we have the ability to address regional issues, such as disease, water resources, transport linkages, etc., that the MCC, by virtue of being country-specific, cannot. In short, it will likely vary considerably from country to country.

One of the basic premises for implementation of the MCC is that it should be demand-driven. We do not want to prescribe the mechanics of how activities would be implemented. I would anticipate that it will vary considerably from country to country, knowing there are no "cookie-cutter" approaches that will work across the board. However, the goal will be to employ simple implementation mechanisms that require less oversight and less U.S. management than traditional projects. There are a variety of mechanisms for spending the funds, such as contracts or grants, but these could be managed by the host country, following their policies and procedures.

Because the management approach of the MCC will be to employ local institutions for country development, it is appropriate that the MCC, too, rely heavily on strong local institutions for the in-country expertise it requires. Economic and financial analysis of specific MCC investments can be contracted locally. Technical advisory services to the MCC can be contracted locally. Monitoring and evaluation can largely be contracted locally. Therefore, we anticipate that the full-time presence of US government employees needed to manage the MCC can be significantly reduced.

Even though we envision a strong reliance on local institutions, there will still be a need for limited MCC staff presence in the field to facilitate, manage and oversee the partnership. Due to the limited staffing, we anticipate that the Ambassador and Embassy staff will play a strong supportive role of the MCC. We also believe that USAID field staff, with its development expertise and knowledge of local culture and context, will play a key role in supporting the MCC.

USAID presence in the field has rightly been repeatedly recognized as its strongest suit. Thirty years of development experience has taught us that country context matters a great deal. I can imagine that our very capable field Missions could provide critical support to the MCC, helping to work with local partners, finding creative, local solutions to problems, and generally facilitating the work of the MCC. The basic USAID activity in many of the likely MCA countries has been knowledge transfer and building local capacity and institutions. In some cases, continued USAID programs in institution building may be necessary for a time to further build country capacity to manage MCC programs and resources. As I have tried to emphasize, while I believe USAID will have a key role in supporting MCC programs, we do not want to adopt a black or white approach to how USAID will relate to the MCC in every country; rather we think each country will need to be reviewed on a case-by-case basis.

CONCLUSION

As I mentioned earlier, there are many practical and operational details to be worked out, which the CEO and MCC need to be involved in and will be best equipped to solve. However, I think we have developed a strong vision of key principles for the MCC. I began by saying that we believe the MCC marks a revolution in the U.S. approach to development assistance. It will help clarify the mission and objectives of foreign assistance, it will provide greater policy coherence by integrating foreign policy expertise, and it will mobilize more resources to help make development truly sustainable.

Spurred by the proposal for the MCC and the changes in the developing world, we are forging a better understanding of foreign assistance and its numerous different goals - the developmental goals, the humanitarian goals, the policy goals, trade-related goals, security goals, etc. We are beginning a process of articulating these goals and matching them with appropriate resources and programs, and developing a strategic approach to US foreign assistance.

For USAID, the MCC has the potential to provide a great model. It is a golden opportunity to prove that development, done right, can work. I urge your favorable consideration of the legislation and thank you for the opportunity to testify.